Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	**MM Docket No. 92-266**
	)	
Rate Regulation	)	

DISCOVERY COMMUNICATIONS, INC.
REPLY TO OPPOSITIONS TO PETITION FOR RECONSIDERATION

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Discovery Communications, Inc. ("Discovery"),[1] by its attorneys and pursuant to Section 1.429 of the Commission's Rules, hereby submits its reply to oppositions to its Petition for Reconsideration[2] of the Commission's Report and Order and Further Notice of Proposed Rulemaking ("*Order*") in the above-captioned proceeding. As shown below, Discovery's proposed modifications to the *Order* are consistent both with the intent of Congress as expressed in the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act")[3] and sound public policy. Equally important, no party has provided a public interest justification for why Discovery's proposed modifications should not be adopted. Therefore, Discovery respectfully urges the Commission to grant the relief requested herein and in its Petition.

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1 Discovery owns and operates The Discovery Channel and The Learning Channel.

2 Discovery Communications, Inc. Petition for Reconsideration (June 21, 1993).

3 Report and Order and Further Notice of Proposed Rulemaking, Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, FCC 93-177 (released May 3, 1993) ("*Order*").

I. INTRODUCTION.

Discovery's Petition demonstrated that the Commission's *Order* if left unchanged would seriously undermine the cable programming industry and thereby an important goal of the 1992 Cable Act: the promotion of consumer access to a wide diversity of programming choices. In support of this position, Discovery explained that its experience in the brief time since the *Order*'s adoption in April is that cable operators no longer are interested in adding new program services. As Discovery stated in its Petition, it has been told by cable systems that this position is due to their concerns about the effects of the new cable rate regulations and their inability to see an economic incentive in adding new program services or in increasing channel capacity.

Discovery proposed three specific modifications to the Commission's cable rate regulations designed to address and ameliorate their adverse consequences to the programming industry and, ultimately, cable consumers. In particular, Discovery asked that the Commission:

(1) Amend Section 76.722(d)(i) to allow for a full flow-through of capital investments related to increasing the technical capability or capacity of cable systems, including a cost of capital component;

(2) Amend Section 76.722(d)(vi) to permit operators an opportunity to earn an additional amount on their investments in new programming, and to allow a full flow-through of net programming costs for all entities regardless of whether the cable operator is affiliated with a programmer; and

(3) Amend Section 76.722(d)(iv) to allow exogenous costs to be calculated from October 1, 1992.

Notably, no party filing an opposition to *any* petition for reconsideration challenged Discovery's central thesis that the Commission's newly adopted benchmark/price cap rate regulatory regime has led to a freeze in the programming market and threatened to undermine the statutory objective of promoting a diversity of cable programming services. Nor did any party dispute that adopting Discovery's proposed modifications would go far towards

reviving the once-vibrant programming market to the ultimate benefit of cable consumers. Rather, commenters opposing the relief sought by Discovery generally gave short shrift to these concerns, focusing instead (in the case of local franchising authorities) on an single-minded insistence on reducing cable rates to the maximum extent possible or (in the case of local telephone companies) on advancing their own competitive interest.

Discovery respectfully submits that, as explained below, none of these parties has set forth any substantial reason for the Commission not to adopt its proposals. The public interest would best be served by policies, such as the modifications that Discovery has suggested, that more equitably balance the objectives of the 1992 Cable Act.

II. PASS-THROUGHS OF INVESTMENTS IN CABLE SYSTEM IMPROVEMENTS AND EXPANSIONS AND IN NEW PROGRAM SERVICES IS NECESSARY TO ACHIEVE THE OBJECTIVES OF THE CABLE ACT.

As Discovery pointed out in its petition, the 1992 Cable Act requires the Commission to balance a number of objectives in its cable rate regulations. In particular, the legislation established a number of goals -- such as making available to consumers a diversity of program services -- that the Commission's rate regulations must also take into account in addition to restraining rates. Among these goals were (1) encouraging cable operators to make investments in network upgrades and improvements, and (2) promoting the availability of diverse, high quality programming.[4]

In its Petition, Discovery explained that the cable rate regulations adopted in the *Order*, however, provide no incentives for cable operators to expand and upgrade their systems or to carry additional program services. Lacking such incentives, cable operators are unlikely to make the socially desirable investments that Congress meant to encourage.

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[4] Furthermore, cable operators that chose to make such investments would be compelled as a practical matter to resort to cost-of-service submissions, rather than the benchmark/price cap approach, to establish rates sufficient to cover their costs.

Discovery's proposal is to provide cable operators with the necessary incentives by allowing them to treat as external, and allow a full pass-through of, the costs of these investments.

A. CABLE RATE REGULATIONS SHOULD ALLOW CABLE OPERATORS TO RECOVER THEIR FULL CAPITAL INVESTMENTS IN SYSTEM EXPANSION AND UPGRADES.

Discovery's Petition proposed that the Commission could best provide cable operators with the necessary incentives to invest in network expansions and upgrades by allowing them to pass through their capital investments for such purposes, rather than limiting their recovery to the Gross National Product Price Index ("GNP-PI") inflation factor under price cap regulation.[5] Discovery explained that the expanded channel capacity would result in the provision of more programming to the public at lower prices.

Parties opposing pass-throughs of the capital investments in system expansions do not dispute that the public interest would be better served by cable systems with larger channel capacity and more modern technological features. Nor do they dispute that allowing such pass-throughs would, in fact, provide cable operators with a financial incentive to make the types of investments that Congress wanted to encourage. Nor, finally, do they dispute that such pass-throughs would assure cable operators of an opportunity to recover the costs of expanding and upgrading their systems. Instead, they argue without explanation as to how it meets the Act's policy objectives that cable operators should be able to recover such investments solely through the price cap regime, constrained by the GNP-PI.[6] These arguments, however, ignore both the congressional intent and the reality that cable operators

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5 *See* Discovery Petition at 3-5.

6 *See, e.g.,* Opposition by the National Association of Telecommunications Officers and Advisors, The National League of Cities, the United States Conference of Mayors, and the National Association of Counties To Petitions for Reconsideration and Clarification at 10-14; Opposition of Bell Atlantic To Petitions for Reconsideration at 5-6; United States Telephone Association Opposition To Petitions for Reconsideration at 4.

will not make socially desirable infrastructure investments without adequate incentives tailored to the financial realities of their industry.

A different issue is raised by local telephone companies that oppose pass-throughs of capital investments on the ground that they themselves are not allowed to recover their investments in network improvements as an external cost, but only as an internal cost subject to price caps.[7] More generally, they argue for parallel rate regulation of cable operators and telephone companies.[8]

The fundamental flaw in the local telephone companies' position is their premise that the Commission should regulate the cable industry in the same manner in which it regulates the local telephone industry. As this Commission already has recognized, such "parallel" regulation is not required by the statute, but in fact would contravene the congressional determination that cable operators are not to be regulated exactly as are traditional common carriers.[9] Furthermore, as a matter of policy there are numerous and substantial reasons for applying differing regulatory regimes to the cable and local telephone industries, which differ significantly in maturity, financial structure, risk, and stage of development.[10]

Thus, the Commission should weigh the need to pass through investments by cable systems in network improvements on its own merits, not on the basis of its regulatory

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7 *See* Bell Atlantic Opposition at 5-6.

8 *See* United States Telephone Association Opposition at 2-3.

9 Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 93-215 at 10-11 & n.10 (released July 16, 1993) ("*Cost-of-Service NPRM*") ("The legislative history of the Cable Act of 1992 indicates a congressional preference that the regulatory framework we adopt for governing cable rates should not closely mirror common carrier regulation").

10 In the particular context of network improvements, the telephone and cable industries are not comparable. For example, telephone companies are much larger than cable systems and maintain a much more constant, and larger, level of network investment, and are not characterized by the "peak and valley" nature of capital investment by cable operators.

policies crafted in the quite different context of local telephone services. There is no dispute about the importance of and congressional interest in promoting the expansion and improvement of cable systems. Given the dramatic freeze in the cable programming market attributed to the April cable rate regulations, the need to allow cable operators to pass through their investments in system expansions and upgrades is compelling.

B. THE COMMISSION SHOULD MODIFY ITS RULES TO PROVIDE CABLE OPERATORS WITH APPROPRIATE INCENTIVES TO ADD PROGRAMMING.

Discovery's Petition also explained that the current regulations simply do not give cable operators sufficient financial incentive to add new programming in order to achieve the 1992 Cable Act's goal of encouraging better and more diverse programming. To provide appropriate incentives, Discovery proposed three specific modifications to the regulations adopted in the *Order*:

(1) Not require operators to subtract the GNP-PI from the programming pass-through calculation;

(2) Eliminate the unfair distinction between the treatment accorded programming costs depending on whether the programming entity is "affiliated" or not with the cable operator; and

(3) Allow a percentage mark-up on program costs.[11]

Arguments raised in opposition to these proposals do not dispute the importance of providing cable operators with adequate incentives to add program services. However, they continue to advocate policies that would deny cable operators such incentives and, indeed, establish significant disincentives. These oppositions are discussed below.

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11 Discovery Petition at 7-10.

1. The Commission Should Allow Pass-Throughs Of Program Service Costs.

The oppositions contain comparatively little discussion of the specific issue of programming pass-throughs. However, local telephone companies argue that programming acquired from "affiliated" suppliers is not an external cost and therefore should not be given exogenous pass-through treatment.[12] These comments, however, do not seem to dispute that program services obtained from non-affiliated programming entities should be treated as external. Moreover, Discovery, which is "affiliated" with several cable multiple system operators, respectfully disagrees with the local telephone company's implicit assumption that transactions between affiliated cable operators and programmers are presumptively, and *per se*, improper. There is no evidence that such is the case in the cable industry. In any event, Discovery submits that any potential abuses can best be addressed on a case-by-case basis, rather than through a draconian rule which is unsupported by any record evidence of actual abuse in the marketplace.

As for Discovery's proposal to allow cable operators an opportunity to markup their programming costs, opponents argue merely that doing so might cause rates to rise. They omit any consideration of the customer benefits that would accrue from additional programming, nor do they question that such a markup could help encourage operators to effectuate the congressional goal of making diverse, quality program services available to consumers. As Discovery and others have shown, the Commission must balance a variety of statutory policies; it respectfully submits that its experience since April strongly suggests that a different balance must be struck in order for the Act's objectives in the area of program services to be achieved.

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12 GTE's Opposition to Petitions for Reconsideration at 15-16.

Programming costs are unique to cable systems, and are a major component of their operating costs. Discovery submits that the reasons for passing through the net investments in acquiring new programming as external, regardless of corporate affiliation, and for allowing operators an opportunity to markup their programming acquisitions, remain compelling.

2. The Commission Should Also Apply The Benchmark Rates In A Manner That Provides Incentives Cable Operators To Add New Program Services.

The claim by opponents of pass-throughs that the benchmark/price cap regime provides cable operators with sufficient incentive to add program services is unjustified. If when adding channels an operator is required to go back to the benchmark rates to determine what new revenues could be obtained,[13] the amount would not be satisfactory because the per channel benchmark rates decline as the number of channels increases. This declining rate structure will present a problem if the benchmark tables are to apply at all to program services added in the future.

One solution would be to allow the cable operator to add new channels at the maximum permitted rate for its system (*i.e.*, the Maximum Initial Permitted Rate per Channel [FCC Form 393, Part II, Worksheet 6, Line 600]). Another approach would be to allow cable operators to recalculate the maximum per channel benchmark and apply the new, lower figure only to the newly added channels, while continuing to use the old per channel rate for existing offerings. Either approach is better than the existing system. Discovery urges the Commission, regardless of which method it ultimately adopts to solve the problem, to ensure that its approach creates the proper incentives to support high quality programming.

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13 It is currently unclear whether an operator adding a new program service would need to go back to the benchmark tables to determine what effect the additional channel would have on its rates, or would ascertain its new rate in some other manner.

III. EXOGENOUS COSTS SHOULD BE CALCULATED FROM OCTOBER 1, 1992.

Discovery demonstrated in its Petition that the public interest would be served by allowing cable operators to flow-through external or exogenous costs incurred since October 1, 1992.[14] Forcing cable operators to recover *all* costs incurred since September 30, 1992, to the effective date of rate regulations through the general inflation adjustment will, as Discovery pointed out, force rates to non-compensatory levels. *See Federal Power Commission v. Hope Natural Gas, Inc.*, 320 U.S. 591 (1944).

No party seems to have directly opposed this aspect of Discovery's Petition. Several local authorities, however, opposed a petition by another party to allow a pass-through of *all* costs incurred since September 30, 1992, on the grounds that this would allegedly amount to a double recovery because the benchmarks incorporate data from systems that already bear such costs and presumably reflect them in the benchmarks.[15] Discovery submits that this concern, whatever its merit, is completely irrelevant to external costs incurred *after* September 30, 1992. External costs incurred subsequent to that date are not "incorporated" in the benchmark rates. Thus, there is simply no "double-counting" if external costs incurred since September 30, 1992, are passed through.

Accordingly, Discovery again urges the Commission to modify its rate regulations to eliminate any "gap" in cost recovery by specifically allowing cable operators to recover exogenous costs incurred between October 1, 1992, and the effective date of rate regulation to be passed-through to the extent that they, together with internal costs, exceed the general inflation adjustment.

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14 Discovery Petition at 6-7.

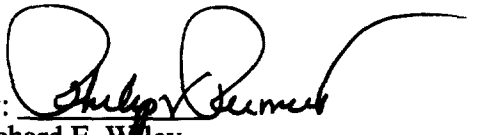
15 *See* King County, Washington; Austin, Texas; Dayton, Ohio; Gillette, Wyoming; Montgomery County, Maryland; St. Louis, Missouri; and Wadsworth, Ohio Opposition to Petitions for Reconsideration at 25-26.

IV. CONCLUSION.

Discovery respectfully requests the Commission to balance the 1992 Cable Act's purpose of driving down cable rates with the statute's concomitant purpose of promoting new and diverse programming. For the foregoing reasons and for the reasons set forth in its Petition for Reconsideration, Discovery respectfully suggests that the public interest would be served by adopting the changes proposed in its Petition for Reconsideration.

Respectfully submitted,

DISCOVERY COMMUNICATIONS, INC.

By: 

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August 4, 1993

CERTIFICATE OF SERVICE

I, Phyllis C. Hall, a legal secretary at the law offices of Wiley, Rein & Fielding, do hereby certify that on this 4th day of August, 1993, I caused to be served a true copy of the foregoing "Discovery Communications, Inc. Reply To Oppositions To Petition For Reconsideration" to be sent by U.S. first class mail, postage prepaid, to the parties on the attached service list.

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